

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.
Telephone Number:

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PLR-105177-08
Date:
June 23, 2008

Legend

X =

Trust =

State =

d1 =

d2 =

d3 =

d4 =

n =

Dear :

This letter responds to your letter dated January 30, 2008, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

Facts

X was incorporated under the laws of State on d1. X elected to be an S corporation effective d2. On d3, shares of X's stock were sold to Trust. X represents that Trust was qualified to be an Electing Small Business Trust (ESBT), within the meaning of § 1361(e), however, no election was made under § 1361(e)(3) to treat Trust

as an ESBT. Consequently, Trust was an ineligible shareholder, and, as a result, X's S corporation election terminated on d3.

X represents that there was no intent to terminate X's S corporation election and that the failure to timely file the ESBT election for Trust was inadvertent and not motivated by tax avoidance or retroactive tax planning. For all taxable years, X and X's shareholders income was reported consistent with X qualifying as an S corporation. In addition, X and X's shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible shareholder and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT is a permissible shareholder.

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2)-(5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

Conclusion

Based solely on the facts submitted and representations made, we conclude that X's S corporation election was terminated on d3 when Trust purchased stock in X because Trust failed to timely file an ESBT election under § 1361(e)(3). We further conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on and after d3, unless X's S corporation election is otherwise terminated under § 1362(d) and provided that the following conditions are met. As an adjustment under § 1362(f)(4), a payment of \$n and a copy of this letter must be sent to the following address: Internal Revenue Service, Cincinnati Service Center, 201 West Rivercenter Blvd., Covington, KY 41011, Stop 31, Terri Lackey, Manual Deposit. This payment must be sent no later than d4. In addition, the trustee of Trust must file an ESBT election effective d3 with the appropriate service center within 60 days of the date of this letter. A copy of this letter should be attached to the ESBT election.

Accordingly, the shareholders of X must include in their income their pro rata share of separately stated and nonseparately computed items of X as provided in § 1366. and make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. This ruling is contingent upon X and each of its shareholders filing any amended returns and making such adjustments that are necessary to properly reflect the reporting of X's items of S corporation income. Additionally, Trust and Trust's beneficiary must file any amended returns and make adjustments that are necessary to properly reflect the treatment of Trust as an ESBT.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

If all of the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify the Cincinnati Service Center that its S corporation election has terminated.

Except for the specific ruling above, no opinion is expressed or implied concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed or implied regarding X's eligibility to be an S corporation or Trust's eligibility to be an ESBT.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

/s/

Tara P. Volungis
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: